

## Message Text

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ACTION EUR-12

INFO OCT-01 EA-07 ISO-00 AID-05 CIAE-00 COME-00 EB-08  
FRB-03 INR-07 NSAE-00 USIA-06 TRSE-00 XMB-02  
OPIC-03 SP-02 LAB-04 SIL-01 OMB-01 NSC-05 SS-15  
STR-04 CEA-01 L-03 H-01 PA-01 PRS-01 AGRE-00  
/093 W

-----014415 300651Z /15

R 292334Z JUL 77

FM AMEMBASSY OTTAWA  
TO SECSTATE WASHDC 4295  
INFO AMEMBASSY BONN  
AMEMBASSY LONDON  
AMEMBASSY PARIS  
AMEMBASSY TOKYO  
AMCONSUL MONTREAL  
ALL OTHER CONSULATES GENERAL IN CANADA (POUCH)

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USOECD

DEPARTMENT PASS TREASURY, FRB

E.O. 11652: N/A  
TAGS: EFIN, ECON, CA  
SUBJECT: EXCHANGE RATE DEVELOPMENTS

REF: OTTAWA 6762

1. SUMMARY. CANADIAN DOLLAR FELL JULY 26 BELOW 94 U.S.  
CENTS AND SO FAR HAS NOT RECOVERED. DROP OF NEARLY  
ONE-HALF OF ONE PERCENT WAS ASCRIBED TO STATEMENT BY  
FINANCE MINISTER MACDONALD THAT INFLATION RATE TARGET  
FOR 1977 WOULD NOT BE MET, BUT ALSO REFLECTED VOLATILE  
FOREIGN EXCHANGE MARKETS AND GENERAL LACK OF CONFIDENCE

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IN CANADIAN ECONOMIC PERFORMANCE AS WELL AS TECHNICAL  
FACTORS. INTERVENTION BY BANK OF CANADA TO SMOOTH DECLINE  
WILL PROBABLY BRING OFFICIAL INTERNATIONAL RESERVES  
BELOW FIVE BILLION FOR JULY. PERIODIC VOLATILITY IN  
CANADIAN DOLLAR EXCHANGE RATE IS APT TO CONTINUE. END  
SUMMARY.

2. SHARP DROP IN CANADIAN DOLLAR EXCHANGE RATE OF NEARLY ONE HALF CENT JULY 26 HAS BEEN ASCRIBED BY BANK OF CANADA AND MOST OTHERS TO STATEMENT BY FINANCE MINISTER MACDONALD ON PREVIOUS DAY THAT CANADA WOULD PROBABLY NOT MEET TARGET FOR THE SECOND YEAR OF THE ANTI-INFLATION PROGRAM OF A SIX PERCENT INCREASE IN THE CPI FOR THE TWELVE MONTHS ENDING IN NOVEMBER. FOREX MARKET REACTION TO THIS ANNOUNCEMENT IS CURIOUS. FAILURE TO MEET TARGET HAS BEEN CLEAR FOR SOME TIME IN VIEW OF PRICE INCREASES ALREADY REGISTERED IN SEVEN MONTHS SINCE LAST NOVEMBER. OTHER PRINCIPAL REASON BEHIND DROP MAY HAVE BEEN GENERAL VOLATILITY IN OTHER FOREIGN EXCHANGE MARKETS. IT WAS ALSO RUMORED THAT A NUMBER OF CONVERSIONS OF RECENT OFFSHORE CANADIAN BORROWING SCHEDULED FOR EARLY IN THE WEEK DID NOT TAKE PLACE ON SCHEDULE. THERE MAY HAVE BEEN SOME ANTICIPATION OF PRESSURE ON THE CANADIAN DOLLAR AT THE END OF THE MONTH WHEN PAYMENTS ARE DUE ON INTEREST ON EXISTING OFFSHORE DEBT.

3. THE PRESS REPORTED INTERVENTION BY THE BANK OF CANADA THE SAME DAY TO EASE THE DROP. FIGURES ON INTERNATIONAL RESERVES TO BE PUBLISHED SHORTLY FOR JULY WILL PROBABLY SHOW A DROP BELOW U.S. DOLS 5 BILLION, THE FIRST TIME RESERVES WILL HAVE BEEN BELOW THIS AMOUNT (MEASURED IN U.S. DOLLARS) SINCE 1970. THE LEVEL OF RESERVES DROPPED U.S. DOLS 134.1 MILLION IN JUNE, AND HAS LIMITED OFFICIAL USE

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GENERALLY TENDED TO DRIFT DOWNWARD SINCE JANUARY AS INTERVENTIONS HAVE SMOOTHED THE DOWNWARD TREND IN THE CANADIAN DOLLAR EXCHANGE RATE. THE NET LOSS IN RESERVES FROM THE BEGINNING OF THE YEAR THROUGH JUNE WAS U.S. DOLS 561.4 MILLION. THIS IS LESS, HOWEVER, THAN THE ONE MONTH LOSS OF OVER DOLS 750 MILLION DURING NOVEMBER 1976 AT THE TIME OF THE QUEBEC ELECTIONS WHICH WAS MORE THAN GAINED BACK THE FOLLOWING MONTH.

4. FOREX MARKET DEVELOPMENTS FOR THE CANADIAN DOLLAR MAY CONTINUE TO BE DOMINATED BY PSYCHOLOGICAL NON-EVENTS SUCH AS MACDONALD'S STATEMENT JULY 25 AS MUCH AS BY ANY REAL DEVELOPMENTS. WHILE THE ECONOMIC OUTLOOK IS IMPROVING (SEE REFTTEL), THERE IS LESS THAN BOUYANT OPTIMISM. PROGRESS AGAINST INFLATION REMAINS PAINFULLY SLOW. UNCERTAINTY REMAINS ABOUT CANADA'S ABILITY TO CAPITALIZE ON THE SLIDE IN ITS EXCHANGE RATE SINCE LAST YEAR BY BRINGING LABOR COST INCREASES FIRMLY UNDER CONTROL AND FUNDAMENTALLY STRENGTHENING PRODUCTIVITY BEYOND EXPECTED CYCLICAL IMPROVEMENTS IN ORDER TO IMPROVE ITS COMPETITIVE POSITION.

5. ON THE POSITIVE SIDE, THE CURRENT ACCOUNT BALANCE

IS EXPECTED TO SHOW SOME MODEST FURTHER IMPROVEMENT FROM THE DOLS 4.2 BILLION DEFICIT REGISTERED IN 1976. THE MERCHANDISE TRADE SURPLUS RAN AT A MONTHLY AVERAGE OF DOLS 190 MILLION IN THE FIRST HALF OF THIS YEAR, A RATE WHICH IS EXPECTED TO CONTINUE OVER THE NEXT TWO QUARTERS. OFFSHORE BORROWING IN THE FIRST HALF RAN AT A MONTHLY AVERAGE OF SOME DOLS 700 MILLION. DOMESTIC INTEREST RATES ARE NOT EXPECTED TO MOVE MUCH LOWER.

6. ON THE NEGATIVE SIDE, THE OUTFLOW TO SERVICE EXISTING CANADIAN OFFSHORE DEBT IS RUNNING ABOUT DOLS 300 MILLION PER MONTH. THE TRAVEL DEFICIT CONTINUES TO RISE. EXPORT GROWTH OF THE EUROPEAN COMMUNITIES AND JAPAN HAS

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BEEN SLUGGISH AND IN SOME MONTHS HAS BEEN NEGATIVE. RESTRICTIONS ON DIVIDEND PAYMENTS ARE SCHEDULED TO BE LIFTED IN OCTOBER, AND DIVIDEND OUTFLOWS COULD JUMP AT THAT TIME UNLESS RESTRICTIONS ARE EXTENDED BY LEGISLATION.

7. GIVEN SUCH UNCERTAINTIES, A MAJOR REVERSAL OF THE DOWNWARD TREND IN THE EXCHANGE RATE SEEMS UNLIKELY. SOME FURTHER DETERIORATION IS POSSIBLE, BUT TRADING IN THE NEXT FEW MONTHS IS MOST LIKELY TO REMAIN AT (OR ONLY

SLIGHTLY BELOW) THE 93-95 CENT RANGE. ENDERS

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## Message Attributes

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